OBSERVATIONS AND COMMENTS

(Input from COE, PEMD, OPCD, OFA-MOF)

OVERALL COMMENTS:

- Need to understand the models and the assumptions embedded in them to assess the validity of the estimated impacts/forecasts. It will be important to understand the sensitivity of the models and the financial impacts to the assumptions. Sensitivity analysis would allow the government to make better informed decisions and to develop a risk based outlook to manage potential fluctuations in the cost of these initiatives.

- Given the scale and scope of the initiatives that are being proposed, it is important to note that there will be significant incentives/disincentives being introduced. It will be important to understand how these may impact the behaviour of various key stakeholders going forward and hence the assumptions built into the models and the financial estimates.

- The submission states that the electricity prices are projected to increase above inflation for the foreseeable future. While there are a number of initiatives referenced in the deck to bend the cost curve, it is not clear what the estimated impact of these changes would be. Are these measures projected to limit the increases in the price of electricity at or below inflationary increases? Otherwise, the widening gap will continue to drive need for government action, creating future pressures on the Fiscal Plan.

- With so many proposed changes impacting different consumers, and costs shifting from the rate-base to the tax base, it will be important to understand the profile/net impact of the changes on different customer groups and geographies. Need to know the net winners and net losers.

- Energy noted that 2017-18 fiscal impacts were full year, also noted that many initiatives will likely take 3 to 6 months to roll out.

- Energy notes once OEB fix rate regime is in place, government could revisit the $38 distribution cap

GLOBAL ADJUSTMENT (GA) SMOOTHING:

- Energy notes tThe GA is reduced to achieve the initial 25 percent reduction (Total Bill) based on the projected price for the average Toronto Hydro customer. The modelling then assumes GA is removed to achieve the flat 2 percent increase each year per to 2021.

COE

- The submission assumes that the proposed GA smoothing will receive the favourable accounting treatment; hence the provincial debt and the fiscal plan would not be impacted.
    - There are a number of complex issues that need to be addressed and stringent criteria to be met to achieve a satisfactory path forward. Several requirements are high risk.
    - If this key assumption re: favourable accounting treatment is incorrect, the impacts would be significant and can vary depending on the market changes. So, in addition to having a significant fiscal impact, the proposed plan would also introduce significant volatility to the medium- to long-term fiscal plan (as interest rates, energy prices, consumer behaviour change, the financial impacts would continue to change).

- Does the GA smoothing apply to all customers or just those that are part of the Regulated Price Plan?
    - Our current working assumption is that the Ministry of Energy's proposal/cost estimates are based on the GA applying to those customers currently participating in the Regulated Price Plan. If so:
        - What would be the financial impact/revised cost estimate that includes customers that are eligible for RPP, but have opted out?
        - Given the new incentives, the customers who have previously chosen to out of RPP may want to opt in or argue that the incentives be expanded based on the RPP eligibility rather than RPP enrolment. (Ron's estimate is that this could create a deferral, and cumulative debt and interest pressure of about 17%, hence increasing financial risk by that amount).
        - How will the opt-in/opt-out provisions set/refined to ensure there is no gaming.
            - If everyone opts in to benefit from the lower prices, how will the government ensure that they will continue to be part of the plan when the prices start to increase?
            - If the consumers who benefit from RPP are allowed to opt-out later as $ higher payments are needed to pay for the deferred GA amount, the government may face a vicious cycle (as more people opt out, the recovery $/% per remaining household increases, which further creates incentives to opt out of the RPP), possibly stranding the balance as unfinanced debt. Is the government assumed to be underwriting this risk? To deal with potential stranded debt?

- The current projections use nominal interest rates of 5%. The average interest rate in Canada between 1990 and 2017 was 5.94% (from high of 16% in Feb 1991 to 0.5% in April 2009), which includes the last decade that has experienced historically low interest rates. Given the 30 yr projected time horizon, what would be the impacts and funding requirements be at different:
    - Interest rates; and
    - Scenarios for electricity prices.

- It is unclear how and why the GA borrowing requirements are changing so dramatically between various drafts of the submission (from $5-7B in the earlier decks to $1.5-$2B).

OFA

- No discussion with OAG; in previous Annual Reports, the OAG has raised concerns about the appropriateness of recognizing rate regulated assets and liabilities.
- The structure, term and timing of the financing for GA smoothing are highly dependent on the IESO's forecast of GA costs.
  - For example, decreased market prices of electricity would lead to higher GA costs to ensure payments to generators. While customers traditionally pay both the reduced market price and higher GA to recoup these costs, the entity financing the GA would need to have increased borrowing.
  - Volatility in prices and GA could lead to much variability in the amount borrowed.
  - Cost is also highly dependent on actual interest rates over time.
- This proposal subsidizes near-term consumers at the expense of long-term and future consumers.
- The current RPP proposal does not specify if those on retail contracts would be eligible for the GA smoothing benefit.
- While not stated in the deck, Energy staff have stated that Energy's analysis includes estimated costs based only on current RPP customers, not RPP-eligible customers that have currently opted out.
  - If the GA smoothing impact is an incentive to opt back in over time, the cost of the proposal would increase.
  - Energy staff have staed that about 10 TWh of consumption load has opted out, versus about 60 TWh currently in the RPP.
  - If RPP customers are not prevented from opting out later when the recovery period starts, then the remaining RPP customers would either have to pay more, or there would be a shortfall in recovery and fiscal impact.
- As stated in the deck, this proposal is highly dependent on receiving a favourable accounting/legal treatment. Otherwise, there would be a fiscal impact.
- Increased borrowing over time would strain the province's ability for continued borrow.
- Annual borrowing could range from $1.6 Bn to $3 Bn with accumulated debt peaking at $20 Bn to $33 Bn depending on the scenario chosen.
- It should be noted, that unlike a mortgage where payments from the outset are used to pay for both interest and principal costs, the financing undertaken for GA smoothing would not pay principal amounts for the near longer term, and interest would be capitalised instead.
- Conservation efforts are hampered when across the board reductions in the cost of electricity are imposed. This will diminish price signals and other incentives to reduce consumption.

- The analysis is performed on a “typical” customer. Energy deems this to be a Toronto Hydro customer with 750 kWh monthly consumption, however issues may arise in this assumption:
    - The Delivery Cost component of a hydro bill varies across distributors even at the same monthly consumption amount. However the electricity component of the bill - which is targeted by GA Smoothing proposals - would stay the same as RPP prices are applied province-wide.
    - The proportionate impact of changes targeting the Electricity component of the bill would vary from LDC to LDC.
    - Unlike OREC or the former OCEB program which apply a rebate/benefit on a proportion of the total bill, this GA smoothing proposal would have varying levels of proportionate impact.
    - ENERGY’s deck uses Toronto Hydro, a higher cost distributor, as an example. As a result, a 25% impact bill impact from GA smoothing for Toronto Hydro would have a much greater impact for other, lower-cost, distributors, where the electricity component of the bill is larger in proportionate terms.
    - This across the board reduction for GA costs would not targeting those with higher electricity bills, as it would be reducing the electricity component equally on a dollar value basis for all customers.
    - If the objective of this proposal is to provide a 25% reduction to electricity bills across the board, an OREC-type program would be more appropriate to achieving this policy outcome, compared to the disparate reductions provided through a GA smoothing approach.

Legal Risk

- Legal advice on the constitutional risk posed by the proposal to defer the current costs to consumers of the global adjustment, to be paid for by consumers in future years, noted a moderately high constitutional risk of resulting in an unconstitutional tax. It creates a refinancing structure which results in future consumers paying disproportionately more of the GA cost and therefore cross-subsidizing near-term consumers.
    - This advice was based on a review of the proposal from February 9, 2017. The Ministry’s draft Cabinet submission indicates this risk could be eliminated, either up front or retroactively, by the imposition of a valid tax.

RURAL AND REMOTE RATE PROTECTION PROGRAM (RRRP):

COE

- Overall, the program is likely to create disincentives towards productivity and performance improvements to drive down delivery costs/changes. Furthermore, the proposed approach may create an incentive for LDCs that fall just outside the cut-off to drive up their distribution costs to gain eligibility into the program. (Toronto Hydro is just below the cut-off).

- Slide 21 notes that forecasting the funding requirements associated with the RRRP enhancement is difficult due to year to year variability of distribution costs. Further the footnote on the table suggests that while the costs will decrease through 2023 due to rate making changes, the costs are expected to increase post 2023 due to regular rate increases. It is recommended that the Ministry provide a long term forecast, with risk bands that account for variability of distribution costs, to show the full expected financial impact of this initiative on the fiscal plan.

- The submission notes that the forecasting and costing of the program requires alignment between a large number of parties (LDCs/OEB/IESO/Province). As such, it is likely that financial requirements and uncertainty/volatility will increase over time.

OFA

- The goal of the proposal appears to be to remove rate pressures from all residential consumers by shifting costs to the tax base (contributing towards the overall, e.g., 25% reduction target) and to enhance benefits.
- Energy characterizes this enhanced relief as an acceleration toward the OEB initiative for LDCs to have fixed distribution delivery rates,
    - The proposal is a subsidization of high cost distribution as the cap is based on the lowest average distribution rate paid by consumers in this group of LDCs.
    - Fixed distribution delivery rates will benefit higher volume users, who will benefit proportionately more than the cost to lower volume users.
    - Will not impact other delivery charges (e.g., transmission).
- Moving existing RRRP costs to the tax base does not provide mitigation beyond the approx. \$1.60/month for the typical Ontario household (about 1% of the typical 750 kWh/month customer's bills).
- Energy does not clarify if the cap would increase every year to reflect increasing costs.
- RRRP is not income-tested and may be providing additional benefit to non-vulnerable consumers, in contradiction to the policy goal outlined in Energy's deck.
- Increased fiscal exposure if rates that the OEB attributes to the LDCs over time rise faster than the increase in cap.
- Hydro One R2 customers would be receiving this enhancement on top of existing expanded RRRP savings.

ENHANCE ONTARIO ELECTRICITY SUPPORT PROGRAM AND FUND THROUGH GOVERNMENT FUNDING

- ENERGY assumes reaching 100% participation from years 1 to 4, noting it's an optimistic assumption. Not clear if it remains an application based program (notes Premier's preference to make it an entitlement program versus an application program)

COE

- Given the funding requirements for this initiative almost doubles (from $178M in 2017-18 to $334M in 2020-21), we assume that the Ministry of Energy has built in an increase in take-up rates, as well as the financial impact of the 50% enhancement into their costing estimates.

- Current program take-up rate is 30%. Consideration could be given to focussing efforts on increasing the take-up of the existing program, and seeing the effectiveness of the supports, before benefits are further enhanced.
    - Behavioural Insights Unit (BIU) can help support efforts to increase uptake of the program. Increasing awareness of the program + removing barriers to enrolment/making the enrolment process easier is expected to have a significant impact on the program.
    - This approach would not only lower the fiscal impact in the short-term, but ensure that the effectiveness of the program can be assessed before it is scaled up.

OFA

- Moving existing OESP costs to the tax base does not provide mitigation beyond the approx. $0.83/month for the typical Ontario household (about 0.5% of the typical 750 kWh/month customer's bills).
- Energy policy rationale for moving such programs to the tax base is to contribute to the rate mitigation target and not have social programs cross-subsidised by other ratepayers.
    - Note that when OESP was planned, Energy noted that low income support was provided in other rate-regulated jurisdictions and was found to be justifiable so long as it was part of a comprehensive regulatory structure and provided some benefits to other ratepayers, which it was found to do.
- TPD has raised the issue that changes to the design of the OESP should be discussed with the Canada Revenue Agency to ensure that it does not become a taxable benefit. When OESP was created, TPD worked with Finance Canada and Energy to ensure that it was not considered a taxable benefit.
    - Federal government may be unwilling or unable to administer OESP due to complexity and the significant restrictions that apply to using federal tax forms.
    - Energy has stated that it has been in discussions with CRA. A status update from Energy should be sought.
- Would provide on-bill benefits.
- Could contemplate phase-in to manage fiscal impact.
- Could look at phasing out existing fiscally-funded programs also targeted to low income or identified groups (e.g., OEPTC, NOEC).

    - These existing programs are not on the bill, so less direct and less visible electricity cost mitigation.
- Phase-out to reflect time to increase application based OESP reaching an increasing portion of eligible households.
- As program eligibility is based on income and household size, it’s unclear how on-bill benefits would accrue to those living in rental accommodations where electricity bills are included in rent.
- No fiscal impact estimations provided for the costs to add additional groups for eligibility.

ESTABLISH AN LDC AFFORDABILITY FUND:

COE

- The Ministry is proposing to establish a fund, administered by LDC(s), to extend the existing Low-Income Conservation Program to other electricity customers (customers who are not low income but are in arrears of their payments, may be facing disconnection but do not qualify for the existing low-income programs).

- With the eligibility criteria, delivery models and business case still in development, it may be premature to proceed with the proposal. Having a better understanding of why the target households are in arrears of payment would be key to structuring an effective program.

  - BIU can help with addressing the late payments (like we have done with MOF and late payers)
  - Without a clear understanding of why payments are delayed (or how the payment patterns may be changing), there is the danger of incenting adverse behaviour (delaying payments on purpose to become eligible for grant payments) regardless of the capacity to pay.

OFA

- Energy's deck did not explain why these programs should be funded through the tax base.
- It's unclear why there is a requirements for funds to flow in 2016-17 for the fund. Energy does not provide a rationale as to why delay to the 2017-18 year would be unwise.
- The deck notes that there is a fiscal risk if monies used for the fund do not flow before FY year-end 2016/17 and for monies that are sitting in Hydro One at year-end (because of consolidation with province), and a corresponding fiscal pressure in the following years when the funds are flowed from Hydro One (H1) to ratepayers.

IMPLEMENTING ON-RESERVE FIRST NATIONS DELIVERY CREDIT

COE

- Incredibly specific number of customers (21,494), yet such a round and flat estimate of cost @ $13-$20M. Why the broad range? What is included in this model?

OFA

- Energy's deck did not explain why these programs should be funded through the tax base.
    - Energy states that the OEB "suggests that the program could be funded by the tax base" but this was likely to be one of many options noted by the OEB rather than prescriptive advice on the matter.

Remove Debt Retirement Charge Early (DRC) for Non-RPP Class B Consumers

OFA

- Energy's fiscal impact estimation for option does not include interest costs borne by deferring DRC payments to 2018-19 fiscal year. Assumes loss of $197M in 2017-18 will lead to a gain of $197 in 2018-19.
- Prior Budget 2016 language referred to the fixed end date of the DRC as "providing certainty to commercial, industrial and other users, and helping them more effectively plan their business and investment decisions". Extending the fixed end date for industrial users would be counter to this previous Budget commitment.
- MOF would need to conduct a detailed analysis for a refined fiscal estimation in all scenarios.

(NOTE: Additional proposal/investigation sought to target the DRC elimination for Class B customers of specific industry classes.)

- Would need to assess Legal and LDC implementation issues.
- Legal. Class A and Class B users are defined in regulations of the *Electricity Act* which would allow reference to such definitions in setting rates or exempting groups of users under the DRC regulation, which can be done through an LGIC regulation. Change in end date would require a legislative amendment.
- LDCs. Unclear of the viability of targeting DRC reduction for particular groups of customers within Class B, due to requirements for local distribution companies to assess the manufacturing or non-manufacturing nature of each Class B customer.
    - May need to be application based, increasing the implementation timing and burden.
    - Would likely require verification and audit provisions.
- May affect choice of Class B manufacturers larger than 1 MW that are eligible for Class A ICI to not opt to be Class A. Could increase complexity of program cost estimates and administration.
- Could be subject to trade issues – TBD.
- The Industrial Conservation Initiative (ICI) and Industrial Electricity Incentive (IEI) programs had eligibility based on industrial sector; however, this proposal to target specific Class B industries, pose additional complexity:
    - ICI participants are a relatively few large users. Many large industrials are directly connected to the transmission grid. Approximately 1,500 customers fall in this category and significant reductions in electricity costs (10%-34%) compelled compliance based on historical numbers.
        - DRC reduction are estimated to provide only a 4% savings, mitigating the desire for eligible participants to participate.
    - The IEI program has only 22 participants, and each one is required to provide a detailed application in order to be selected for the program.
        - Sheer number of applicants would overwhelm LDCs if the Class B DRC benefit is to target a particular group of participants.

- Forecasting the potential fiscal impact of the proposal would be challenging. The impacted consumption would be Class B customers that are non-RPP and non-ICI customers which could be difficult to identify and forecast.